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No. 94-1033

IN THE
Supreme Court of the United States

October Term, 1994

COMPUTER CURRICULUM CORPORATION,

Petitioner,

v.

INSTRUCTIONAL SYSTEMS, INC.
and
DEBORAH T. PORITZ, ATTORNEY GENERAL
OF THE STATE OF NEW JERSEY,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF OF PETITIONER

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
ARGUMENT	1
CONCLUSION	10

TABLE OF AUTHORITIES

Cases: **Page(s)**

Amerada Hess Corp. v. *Director, Div. of Taxation, New Jersey Dep't of Treasury*, 484 U.S. 941 (1987) 10

American Airlines, Inc. v. Wolens, 1995 U.S. LEXIS 690, No. 93-1286 (U.S. Jan. 18, 1995) 4

Arkansas Elec. Coop. Corp. v. *Arkansas Pub. Serv. Comm'n*, 455 U.S. 998 (1982) 10

Baldwin v. *G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935) 6

Barclays Bank, PLC v. *Franchise Tax Bd.*, 113 S. Ct. 2330 (1993) 10

Brown-Forman Distillers Corp. v. *New York State Liquor Auth.*, 476 U.S. 573 (1986) 1

Chemical Waste Mgmt., Inc. v. *Hunt*, 112 S. Ct. 413 (1991) 10

District of Columbia Court of Appeals v. *Feldman*, 460 U.S. 462 (1983) 2

Edgar v. *MITE Corp.*, 450 U.S. 978 (1981) 10

Edgar v. *MITE Corp.*, 457 U.S. 624 (1982) 6

Page(s)

England v. *Louisiana State Bd. of Medical Examiners*, 375 U.S. 411 (1964) 2

Healy v. *Beer Institute*, 491 U.S. 324 (1989) 1

Itel Containers Int'l Corp. v. *Huddleston*, 112 S. Ct. 293 (1991) 10

Nebbia v. *New York*, 291 U.S. 502 (1934) 6

Pike v. *Bruce Church, Inc.*, 397 U.S. 137 (1970) 1, 7

Rooker v. *Fidelity Trust Co.*, 263 U.S. 413 (1923) 2

Statutory Provisions:

N.J. Stat. § 56:10-1, *et seq.* 1

15 U.S.C. § 1221, *et seq.* 9

15 U.S.C. § 2801, *et seq.* 9

28 U.S.C. § 1738 2

REPLY BRIEF OF PETITIONER

As we explained in the Petition, the court of appeals upheld extraterritorial application of the New Jersey Franchise Practices Act, N.J. Stat. § 56:10-1, *et seq.* ("NJFPA"), to regulate commerce wholly outside New Jersey. In doing so, the court of appeals provided States with a blueprint for evading the Commerce Clause's *per se* prohibition on extraterritorial state regulation, *see Healy* v. *Beer Institute*, 491 U.S. 324, 336 (1989); *Brown-Forman Distillers Corp.* v. *New York State Liquor Auth.*, 476 U.S. 573, 582-83 (1986), based on the court of appeals' unsupportable assertion that "it is the parties' own agreement"—not the State of New Jersey—"which operated to project the New Jersey law outside of New Jersey's borders." Pet. App. 25a. In addition, the court of appeals, applying what is now settled law in the Third Circuit, eviscerated the test of *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137 (1970), by holding that a state law's impact on commerce in other States should not be considered if the law can be described as "facially neutral." Pet. App. 27a-28a. We showed—and neither respondent disputes—that lower courts are divided over these important questions.

The Oppositions to *certiorari* filed by Instructional Systems, Inc. ("ISI") and the New Jersey Attorney General (the "Attorney General") only underscore the need for this Court's review.

1. ISI, but not the Attorney General, argues that this Court cannot decide the questions presented because they were supposedly "not presented in the record in the court of appeals." Opposition of Respondent ISI ("ISI Opp.") 7. This is simply untrue. This case is about nothing *but* New Jersey's power to apply the NJFPA extraterritorially to compel an out-of-state supplier to renew the parties' agreement, potentially in perpetuity, in States outside New Jersey, and to make it illegal for the supplier to sell its products directly to consumers in those States. Whether, as a matter of law, such application of the NJFPA violates the Commerce Clause is the issue on which CCC moved for summary judgment, Pet. App. 32a-33a; it is the issue the district court decided ("The extraterritorial application of the Franchise Practices Act is a *per se* violation of the Commerce Clause," Pet. App. 60a); it is the issue which ISI sought to certify

to the court of appeals ("whether the [NJFPA], *per se* or as applied to the [parties' 1984] Reseller Agreement . . . violates the Commerce Clause," J.A. 1911); it is the issue reviewed by the court of appeals (whether the "statute violates the dormant Commerce Clause when applied to activities of a New Jersey franchise outside New Jersey," Pet. App. 21a); and it is the issue decided by the Court of Appeals: "we see no facial conflict between the NJFPA and the dormant Commerce Clause." *Id.* at 26a. There can be no doubt that the Commerce Clause question is properly before this Court.[1/]

ISI, however, makes the remarkable claim that, as a result of the abstention proceedings in this case, the court of appeals' decision of the Commerce Clause question rested on the full faith and credit statute, 28 U.S.C. § 1738, or the doctrine of *Rooker* v. *Fidelity Trust Co.*, 263 U.S. 413 (1923), and *District of Columbia Court of Appeals* v. *Feldman*, 460 U.S. 462 (1983). *See* ISI Opp. 6, 10–12. That is not so. The court of appeals specifically *rejected* ISI's argument that the state court ruling was preclusive on the Commerce Clause question. Pet. App. 15a–18a. It held that "it is clear from the record" that—as ISI had conceded in the district court—CCC properly reserved the Commerce Clause question, pursuant to *England* v. *Louisiana State Bd. of Medical Examiners*, 375 U.S. 411 (1964). Pet. App. 16a. The court of appeals held that the state-court proceeding was preclusive only with respect to "the state law issues." *Id.* at 20a.[2/]

[1/] The Attorney General makes the erroneous assertion that CCC's Petition has "abandoned" any *per se* challenge to extraterritorial application of the NJFPA. Opposition of New Jersey Attorney General ("NJ Opp.") 13, 14. As the Petition makes clear (at 3, 7, 9–11), CCC expressly relies on the *per se* standard and seeks review because the Third Circuit's decision "directly conflicts with this Court's decisions interpreting the Commerce Clause as imposing a *per se* ban on extraterritorial state regulation." Pet. 9.

[2/] In fact, the earlier abstention proceedings make this case unusually well suited for this Court's review. The New Jersey Supreme Court's decision removes any concern that the constitutional question is being reached before the state courts have had an opportunity to construe the statute more narrowly. The state's highest court has authoritatively declared that it is the policy of New Jersey, as

(continued...)

2. Employing the same legal fictions as those used by the court of appeals, ISI argues that extraterritorial application of the NJFPA was the product of "the parties' volitional action, not state law." ISI Opp. 6. But the argument of the Attorney General of New Jersey shows otherwise.

The Attorney General asks this Court to recognize "[t]he power of every State, reposed not only in its legislature, but also in its judiciary, to act protectively on behalf of its citizens," even when that protection involves the regulation of commerce wholly outside the State. N.J. Opp. 23. To the Attorney General, the terms of a contract should not be "immune from alteration in the public interest." *Id.* at 22. Here, the parties' agreement that California law would govern and that the contract would expire on July 31, 1989 must be revised because it is "contrary to public policy." *Id.* at 23. The Attorney General maintains that a State must be permitted to implement "a public policy" "through both its courts and its Legislature" in order "to protect a franchisee in the interstate market." *Id.* at 22, 24. The Attorney General's position demonstrates that extraterritorial application of the NJFPA cannot be attributed to the parties' private agreement and is directly traceable to the State itself.

ISI repeatedly claims that the NJFPA did not compel the parties to enter into a multistate agreement or to make the agreement exclusive. ISI Opp. 3, 8, 10. But ISI does not and cannot deny that the parties' "private decision making," ISI Opp. 9, provided that the agreement was to be governed by California law and that it would expire on July 31, 1989. After that date, it is solely the NJFPA, not any agreement of the parties, that would obligate CCC to distribute exclusively through ISI in Connecticut, Delaware, the District of Columbia, and five additional States. The NJFPA does not require the parties to enter into an exclusive multistate arrangement, but it forces them to renew that

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[2]/(...continued)
embodied in the NJFPA, to protect New Jersey distributors even when they act outside the State, whatever the parties' own contract may say. The Commerce Clause issue is unlikely to arise again in such pristine form.

agreement, potentially in perpetuity, even though their own "volitional action" expressly provided otherwise.

ISI compares this case to one in which the parties voluntarily agree to reflect the provisions of the NJFPA in their contract. ISI Opp. 9. Yet that example is the very opposite of this case. Here, the parties' choice of law and termination date were overridden by the New Jersey statute. Indeed, the Third Circuit *affirmed* the district court's ruling that ISI could not assert a common-law breach of contract claim because, as a matter of law, the CCC-ISI 1984 Agreement was clear on its face and expired in 1989. Pet. App. 29a, 230a. As the New Jersey Supreme Court explained, "nothing indicates that CCC intended or agreed that the New Jersey law would cover its activities in the sister states of New Jersey." Pet. App. 128a-129a. The state court recognized that the NJFPA has extraterritorial scope *not* because of the parties' contract but rather because "the New Jersey Legislature intended the Act to apply to franchise activities outside of the state." Pet. App. 129a. Like the Illinois statute this Court found preempted in *American Airlines, Inc.* v. *Wolens*, 1995 U.S. LEXIS 690, No. 93-1286 (U.S. Jan. 18, 1995), the New Jersey statute "is prescriptive" and "does not simply give effect to [the parties'] bargains."[3] *Id.* at *16, 17.

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[3] The New Jersey Supreme Court explained that the NJFPA's extraterritorial application was attributable to "State power." Pet. App. 129a. Ignoring the decision of the state *supreme* court, ISI resorts to quoting from the state *superior* court to support its claim that the NJFPA's extraterritorial effect is attributable to private agreement rather than state law. *See* ISI Opp. 4 (citing RA3). But the state's highest court disagreed. ISI's attempt in these circumstances to deny the existence of "state independent action" (ISI Opp. 9) is also flatly foreclosed by long-settled principles of state action, as the Petition explained (at 23-24), and as neither respondent makes any effort to deny. Whether one accepts, for purposes of preemption analysis of a specific federal statute, the *American Airlines* distinction between state-imposed regulation and enforcement of the terms of private agreements set by the parties themselves, or treats the statute's preemptive reach as going further, as two Justices of this Court would have in *American Airlines*, there can be no doubt whatsoever that the instant case involves an assertion by New Jersey of the power to override the contractual regime the parties chose for themselves in States outside New Jersey.

3. ISI's argument illustrates the Third Circuit's dangerous blueprint for evasion of the Commerce Clause. ISI argues, for example, that CCC "agreed to be bound" by the NJFPA because the statute was part of New Jersey law at the time of the parties' agreement. ISI Opp. 9.[4] ISI tries to rationalize the extraterritorial application of the NJFPA as a "condition imposed . . . if CCC entered into a franchise contract with a franchisee having a place of business in New Jersey." *Id.* at 10. ISI suggests that CCC "could have . . . avoided" the provisions of the NJFPA "simply by not entering into a franchise contract," *id.* at 3, and that it could have eliminated the statute's extraterritorial effects by restricting ISI's territory to New Jersey, instead of including other States. *Id.* at 3, 8, 10. As the Petition demonstrates, these arguments merely beg the question of whether New Jersey has the power, under the Commerce Clause, to apply the NJFPA to distribution activities outside its borders or to impose such "conditions" on suppliers doing interstate business with New Jersey distributors. Pet. 19–22.

4. The Attorney General contends that *Healy* and *Brown-Forman* do not apply here because "New Jersey is not attempting to distort local markets elsewhere for its own benefit." NJ Opp. 20. But extraterritorial application of the NJFPA does distort markets in other States—it requires suppliers to continue using New Jersey distributors to sell their goods in these markets even though there are more efficient distribution methods available—and it does so solely for the benefit of New Jersey's economy. In fact, the Attorney General repeatedly argues that New Jersey *must* engage in such extraterritorial regulation in order fully to vindicate the legislature's policy of protecting New Jersey franchisees. *Id.* at 3–4, 23–24, 26–27. Neither respondent disputes

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[4] This legal fiction is more legal fantasy in this case inasmuch as the parties had chosen California rather than New Jersey law; no prior court had ever applied the NJFPA extraterritorially; the New Jersey Appellate Division in this case held that the law did not apply at all to this type of distribution relationship; and the New Jersey Supreme Court itself acknowledged in its 5–2 decision (after two oral arguments) that in this case it was "adapt[ing]" legislation enacted on the model of a typical fast-food franchise "to the rapidly-evolving complexities of the computer industry and its various distribution channels." Pet. App. 85a.

our explanation of the fundamentally protectionist nature of this application of the NJFPA. Pet. 14. And extraterritorial projection of the NJFPA has the anomalous and indeed unprecedented effect of requiring, in States outside New Jersey, that similarly situated franchisees be treated differently based solely on their State of origin. For example, a New Jersey franchisee doing business in New Hampshire would, by virtue of the NJFPA, be effectively insulated from competition from other franchisees while a Vermont or New York franchisee doing business in New Hampshire, or even one of New Hampshire's own citizens, would have no such advantage.

5. The Attorney General also indulges in a series of apocalyptic predictions about the consequences of CCC's position. She argues that its adoption would "strip[] from the states all regulatory power having any extraterritorial effect" (NJ Opp. 14; heading), would leave interstate markets governed "by *no* law whatever" (*id.* at 26), would "fundamentally change the American legal system" (*id.* at 28) and would necessitate "a return to the *Lochner* era of *laissez faire*" (*id.* at 22). These fantastic assertions rest on a fundamental misunderstanding.

The Attorney General misses the distinction between state laws regulating interstate transactions *within* the state that produce incidental effects outside the State and state laws, like the NJFPA, that would make it *unlawful* to engage in transactions wholly *outside* the State. For example, a State may regulate the sale of securities within the State, even though such regulation has incidental interstate effects; but it may not, even to protect in-state interests, enact a securities law that also regulates "transactions which take place across state lines . . . wholly outside the State." *Edgar* v. *MITE Corp.*, 457 U.S. 624, 641 (1982) (plurality opinion). Similarly, a State may regulate the price of milk within its borders in order to protect its dairy farmers, *Nebbia* v. *New York*, 291 U.S. 502 (1934), but it may not "project its legislation into [another State] by regulating the price to be paid in that state for milk acquired there," even if such regulation is believed necessary to fully effectuate its policy, *Baldwin* v. *G.A.F. Seelig, Inc.*, 294 U.S. 511, 521 (1935).

While the Attorney General claims that CCC's position would invalidate a vast array of state unconscionability rules and other state laws, she never points to a single concrete example of such a law that imposes the kind of direct extraterritorial regulation involved here, which makes it unlawful for out-of-state residents to engage in commercial transactions outside the State. Invalidating the extraterritorial application of the NJFPA to transactions in other States does not involve *"Lochnerism"* or create a "regulatory desert." NJ Opp. 27. New Jersey is free to apply its franchise policy within its borders. And, under the Commerce Clause, it is Congress -- *not* New Jersey -- that has the power to regulate franchise activities on a regional or nationwide basis. Nor can New Jersey justify extraterritorial application of its law on the ground that "courts must apply *some* state's law to interpret [a multistate] contract." Pet. App. 24a (emphasis added). This case does not involve a rule of contract interpretation. Pet. 19. And the need to apply "some state's law" certainly does not justify an *unconstitutional* interpretation of *any* state law. Whichever state's law might be applied to interpret the contract, the Commerce Clause precludes New Jersey's legislative policy to provide extraterritorial protection to New Jersey franchisees.

6. Neither respondent makes any effort to defend the Third Circuit's crabbed construction of the *Pike* test, and in fact both Oppositions suggest that the respondents agree with us on the merits of the third question presented.[2] ISI claims this question also was not raised in the record below, suggesting that CCC's summary judgment motion in the district court, and its arguments before the court of appeals, were limited to the *per se* test. ISI Opp. 13. ISI is wrong.

As the court of appeals explained, "the parties argued the *Pike* balancing test in the district court and before us." Pet. App. 27a. The Third Circuit then specifically addressed that issue and

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[2] The Attorney General insists that the NJFPA regulates "even-handedly," but she nonetheless concedes that "the burden upon interstate commerce" must be "weighed" against "[t]he local benefits" of the law. NJ Opp. 14, 27. ISI admits that *Pike* applies even where "a state law . . . does not discriminate against out-of-state participants." ISI Opp. 12.

determined that the NJFPA is constitutional under *Pike* "from a facial standpoint." Pet. App. 27a. However, the court's decision was fatally tainted by its holding that "we do not look at the effect of the state regulation on the commerce of other states when we balance," *id.*, and that, once it is determined that there is no discrimination, "the inquiry as to the burden on interstate commerce should end." *Id.* at 29a. Hence, even if there were to be a remand, the Third Circuit's holding would bar any consideration of the extraterritorial effects of the statute. *Certiorari* plainly is proper to review the court of appeals' holding that the NJFPA could create "no incidental burdens on interstate commerce for purposes of *Pike* balancing" because it "is facially neutral as to the interstate nature of the parties' agreement." *Id.* at 28a. As the Petition shows and respondents do not deny, this holding conflicts with decisions of this Court and most of the other Circuits. Pet. 24–27.

ISI is also incorrect about the state of the record. The burdensome impact of the NJFPA is self-evident: in this case it is being invoked to force a California company to do business throughout the Northeast through a New Jersey company, in perpetuity, rather than distribute its products directly or hire an out-of-state distributor that it feels can do a better job. The undisputed record also shows how this would deprive CCC of the ability to meet rapidly changing market conditions in the computer industry.[9] Yet under the court of appeals' view of *Pike*, all this

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[9] The record shows, for example, that the parties themselves did not create a perpetual distributorship for ISI, J.A. 888, 897–99, 903, because, as ISI's owner explained, "the market changes. The computer industry is very dynamic." J.A. 897. During the term of the 1984 Agreement, the instructional learning industry began a rapid transformation from a relatively obscure collection of start-up firms to a highly competitive $300 million business dominated by Fortune 500 companies with annual sales growth of 25–30%. J.A. 876–81, 1056. CCC became increasingly concerned with ISI's performance, J.A. 904–08, and believed that ISI was losing sales because it was not pricing competitively. J.A. 327, 905. ISI was doing little or no business in eight of the eleven States in its territory, and in some States had not made *any* sales at all for years. J.A. 260, 325, 892–94, 901–02, 908. CCC also cited economic literature to support its argument that franchise termination statutes like the NJFPA have substantial effects on commerce. J.A. 1791.

and any additional evidence of actual interference with commerce in other States would be irrelevant as a matter of law.[7]

7. ISI insists that "[t]his case has no significance to anyone except ISI and CCC." ISI Opp. 15 (heading). The briefs *amici curiae* of the State of New Hampshire, the Computing Technology Industry Association, the National Association of Manufacturers and the Software Publishers Association prove the contrary. Indeed, ISI itself sought mandamus in the court of appeals because of what it described as the "overriding public importance" of the Commerce Clause question,[8] and it sought certification on the ground that this case "affects not only the parties in the instant matter but untold numbers of other New Jersey franchisees operating under agreements where the designated territory extends beyond New Jersey." J.A. 1912. Even the Attorney General sees this case as involving fundamental issues that relate "to all manner of . . . commercial transactions." NJ Opp. 28.

8. ISI argues that extraterritorial application of the NJFPA to regulate interstate distribution is "consistent with" federal policy. ISI Opp. 16 (heading). But ISI's lengthy discussion of the Automobile Dealer's Day-In-Court Act, 15 U.S.C. § 1221, *et seq.*, and the Petroleum Marketing Practices Act, 15 U.S.C. § 2801, *et seq.*, shows only that Congress has carefully restricted franchise protection legislation to these two industries. Congress has *rejected* proposals like the NJFPA, and it has specifically

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[7] ISI tries to trivialize the issues in this case by asserting that the basis for its NJFPA claim is that CCC failed to give ISI 60 days' "notice" prior to nonrenewal. ISI Opp. 5, 13. This assertion, unsupported by any citation to the record, was not raised in any of ISI's prior pleadings or briefs. It is not reflected in any judicial decision in this case. It is also indisputably untrue: CCC informed ISI in July 1988—a full year before the 1984 Agreement expired—that it did not wish to renew the agreement in the eight States. Pet. App. 40a. In January 1989, ISI signed a new agreement, expressly limiting its marketing area to New York, New Jersey, and Massachusetts, that was not to take effect until five months later when the 1984 Agreement expired. *Id.*

[8] Mandamus Brief of Plaintiff-Petitioner, Instructional Systems, Inc., Oct. 25, 1993, at 17.

refused to enact franchise legislation dealing with computers and other office products. Pet. 12 & n.9.

We believe that ISI's suggestion that the Federal Government has no interest in the questions raised by the Petition is plainly incorrect, and that the United States in fact has a strong interest here. If the Court has any question in this regard, it may wish to request the views of the Solicitor General, as it has often done in dormant Commerce Clause cases.[2/] Such a request would be particularly appropriate here inasmuch as the Justice Department, in prior testimony before Congress, has voiced serious concerns over the potential adverse impact of franchise renewal requirements on federal competition policy.

CONCLUSION

The petition for writ of *certiorari* should be granted.

Respectfully submitted,

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[2/] *See, e.g.*, *Barclays Bank, PLC* v. *Franchise Tax Bd.*, 113 S. Ct. 2330 (1993) (*mem.*); *Chemical Waste Mgmt., Inc.* v. *Hunt*, 112 S. Ct. 413 (1991) (*mem.*); *Itel Containers Int'l Corp.* v. *Huddleston*, 112 S. Ct. 293 (1991) (*mem.*); *Amerada Hess Corp.* v. *Director, Div. of Taxation, New Jersey Dep't of Treasury*, 484 U.S. 941 (1987) (*mem.*); *Arkansas Elec. Coop. Corp.* v. *Arkansas Pub. Serv. Comm'n*, 455 U.S. 998 (1982) (*mem.*); *Edgar* v. *MITE Corp.*, 450 U.S. 978 (1981) (*mem.*).

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